

**Letter of Findings Number: 04-20130165**  
**Use Tax**  
**For Tax Years 2009-2011**

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**ISSUE**

**I. Use Tax—Manufacturing Exemptions.**

**Authority:** IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-2.5-4-10; IC § 6-2.5-5-3; [45 IAC 2.2-5-8](#); IC § 6-2.5-5-4; IC § 6-8.1-5-1.

Taxpayer protests the imposition of use tax.

**STATEMENT OF FACTS**

Taxpayer is an Indiana business. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid the proper amount of sales tax for purchases made during the years 2009-2011. The Department therefore issued proposed assessments for use tax and interest. Taxpayer protests a portion of the Department's determination of use tax due. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as necessary.

**I. Use Tax—Manufacturing Exemptions.**

**DISCUSSION**

Taxpayer protests the assessment of use tax on gas cylinders that it argues were used in manufacturing and therefore exempt from sales/use tax; however, the auditor determined that the cylinders were not directly used in direct manufacturing and assessed use tax on the rental of the cylinders. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

Department refers to IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Also, Indiana imposes a complementary use tax under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

"Use" means the "exercise of any right or power of ownership over tangible personal property." IC § 6-2.5-3-1(a). In effect and practice, the use tax is generally functionally equivalent to the sales tax. See *Rhoades v. Ind. Dep't of State Revenue*, 774 N.E.2d 1044, 1047 (Ind. Tax Ct. 2002).

An exemption from use tax is granted for transactions where the sales tax was paid at the time of purchase pursuant to IC § 6-2.5-3-4. There are also additional exemptions from sales tax and use tax. IC § 6-2.5-5 et seq. IC § 6-2.5-5-3 provides an exemption for machinery, tools, and equipment directly used in the purchaser's direct production of tangible personal property.

Finally, IC § 6-2.5-4-10(a) states:

A person, other than a public utility, is a retail merchant making a retail transaction when he rents or leases tangible personal property to another person other than for subrent or sublease.

Since Taxpayer rents the cylinders from the vendor, Taxpayer is involved in a retail transaction as defined by IC § 6-2.5-4-10(a). Since Taxpayer did not pay sales tax at the point of purchase, the use tax is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, as provided by IC § 6-2.5-3-2(a), unless an exemption applies.

Here Taxpayer argues that the cylinders containing the gases become a part of the welding unit and thus should be exempt because the welding unit is used in Taxpayer's manufacturing process. Under IC § 6-2.5-5-3(b):

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

(Emphasis Added).

Department regulation [45 IAC 2.2-5-8\(c\)](#) provides that materials are directly used in the production process if, "they have an immediate effect on the article being produced." Property has an immediate effect "if it is an

essential and integral part of an integrated process which produces tangible personal property."

However, [45 IAC 2.2-5-8\(g\)](#) also provides that:

The fact that particular property may be considered essential to the conduct of the business of manufacturing because its use is required by law or by practical necessity does not itself mean that the property "has an immediate effect upon the article being produced."

According to Taxpayer, the welding gas cylinders are necessary to contain the welding gases. Taxpayer believes that without the containment of the gases in the cylinders, Taxpayer's welding process could not occur. However, despite the fact that the cylinders are necessary and essential, the cylinders are not directly used in the direct production of tangible personal property, as required to qualify for sales and use tax exemption.

When a taxpayer claims it is entitled to a tax exemption, it bears the burden of proving that the terms of the exemption have been met. *Indiana Dep't. of Revenue v. Interstate Warehousing*, 783 N.E.2d 248, 250 (Ind. 2003). The Department will strictly construe the exemption statutes against the taxpayer claiming the exemption. *Id.* Thus, "[W]here such an exemption is claimed, the party claiming the same must show a case, by sufficient evidence, which is clearly within the exact letter of the law." *Indiana Dep't. of State Revenue, Sales Tax Division v. RCA Corp.*, 310 N.E.2d 96, 101 (Ind. Ct. App. 1974). Accordingly, the taxpayer claiming exemption has the burden of showing the terms of the exemption statute are met. *General Motors*, 578 N.E.2d at 404.

In the Taxpayer's production process, the cylinders are connected via a series of hoses to the actual welding unit(s). The cylinders are not part of the actual welding equipment but rather contain the gases used by the welding equipment. Therefore, Taxpayer has not met its burden to prove the proposed assessment of use tax on the cylinders is wrong, as provided by IC § 6-8.1-5-1(c). Thus Taxpayer's protest regarding the gas cylinders is denied.

Taxpayer also protests the imposition of tax on rental fees paid on a digger used in constructing the manufacturing site.

Department again refers to IC § 6-2.5-5-3(b) which states:

Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

Department next refers to IC § 6-2.5-5-4 which states:

Transactions involving tangible personal property are exempt from the state gross retail tax if the person acquiring the property acquires it for his direct use in the direct production of the machinery, tools, or equipment described in section 2 or 3 of this chapter.

Equipment and machinery used to construct or prepare a manufacturing site are not used in the actual production process. The digger Taxpayer rented was used to prepare the site for the eventual placement of equipment and machinery that in turn would be directly used in the actual production process. The rental of the digger is not exempt.

Therefore Taxpayer has not met its burden to prove the proposed assessment wrong, as provided by IC § 6-8.1-5-1(c). Thus Taxpayer's protest regarding the equipment rental is denied.

#### **FINDING**

Taxpayer's protest of the assessment of tax on the both the cylinders and the digger is denied.

*Posted: 09/25/2013 by Legislative Services Agency*

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